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C O N F I D E N T I A L SECTION 01 OF 02 HARARE 001175

SIPDIS

AF/S FOR BNEULING
NSC FOR SENIOR AFRICA DIRECTOR C. COURVILLE
USDOC FOR ROBERT TELCHIN
TREASURY FOR JOHN RALYEA
PASS USTR FOR FLORIZELLE LISER
STATE PASS USAID FOR MARJORIE COPSON

E.O. 12958: DECL: 12/31/2009

TAGS: [ECON](#) [EFIN](#) [PGOV](#) [ZI](#)

SUBJECT: ZIMBABWE STOCK MARKET PARALYZED

REF: HARARE 1158

Classified By: Charge d'affaires Eric T. Schultz a.i. for reason 1.4 b/
d

Summary

1. (C) The Zimbabwe Stock Exchange (ZSE) has virtually ground to a halt in reaction to GOZ stopgap measures to help close the budget shortfall and finance the burgeoning domestic debt. The introduction of a withholding tax on the sale of securities, and stricter enforcement of requirements for institutional investors to buy government securities sparked a selling frenzy. A sharp increase in short-term T-bill rates further spurred the rush to unload stocks in a market without buyers, thus paralyzing the Exchange. The ZSE, which quickly entered into talks with the Ministry of Finance, expects that trading, once it resumes, will be very thin, whatever the outcome of discussions. The state's heavy-handed measures to bring the budget under control without addressing fundamental economic reform are taking a toll on the investment climate and the economy in general.
End Summary

A New Withholding Tax on Securities Sales...

2. (SBU) In his August 16 Mid-Term Fiscal Policy Review (reftel), Finance Minister Herbert Murerwa announced that, effective September 2005, the GOZ would assess a ten percent withholding tax on the sale of securities in addition to the pre-existing ten percent capital gains tax, two percent stamp duty, and 20 percent taxation of dividends. Following the announcement, and with the subsequent upward revision of the official inflation rate to 254.8 percent, the 91-day Treasury bill yield shot to 265 percent from 191 percent.

...Triggers Sell-Off

3. (SBU) Investors immediately began shifting their shares out of the market and into Treasury bills to take profits and to avoid the withholding tax. The stock market had been one of the few legally available investments in Zimbabwe that could compete with inflation. By announcing the withholding tax two weeks prior to its implementation, the GOZ created an incentive for an immediate sell off. The measures brought the ZSE's bull run (260 percent nominal increase in value since January 2005) to an end and are threatening to cause a stock market crash. The key industrial index closed on August 19 down 12.64 percent on the previous week; the mining index closed down 21.94 percent.

Institutional Investors Compelled to Buy Government Securities...

4. (SBU) The supplemental budget also signaled stricter enforcement of the prescribed proportion of pension and insurance funds to be allocated to GOZ securities. Until now, fund managers and the National Social Security Authority, which make up 90 percent of the market, had ignored the requirement to allocate fixed percentages of their portfolios to government securities. The allocation requirement for short-term and long-term insurance investments is 25 percent and 30 percent respectively; for private pension funds and for the National Social Security Authority it is 35 percent. Furthermore, insurance and pension funds previously had valued their assets at their original purchase price rather than at the current market value, as is now required under the supplemental budget.

...to Finance the Budget Deficit

15. (SBU) According to one leading analyst, the GOZ had not enforced the 35 percent prescribed asset ratio until now for lack of treasury bills on the market. The GOZ,s failure to attract foreign financing of public debt, however, has compelled the Reserve Bank to issue more paper, and the GOZ to enforce the higher asset allocation requirement to ensure a market. With Murerwa,s statement, fund managers began unloading securities (which had increased in value much faster than the prescribed assets) to meet the 35 percent requirement. The announcements fuelled the rush to sell in a market lacking buyers, exacerbating the market,s paralysis.

GOZ/Zimbabwe Stock Exchange Negotiations

16. (SBU) The ZSE, in hastily convened talks with the Ministry of Finance over the new rules, does not predict a market crash, but expects trading, once it resumes, to be very thin, whatever the outcome of discussions. A well-placed broker told PolAsst that these negotiations centered on combining the announced withholding tax and the pre-existing capital gains tax into a new ten percent capital gains tax taken at the point of sale either by the stock brokerage or by the Zimbabwe Revenue Authority (ZIMRA). In the past, individual taxpayers were left to declare their stock market profits in their tax returns, which many investors failed to do.

Comment

17. (C) The end effect of the GOZ,s heavy hand on the securities market will likely be to reduce rather than increase tax revenue as the market becomes increasingly thin and shallow. Murerwa,s fiscal measures are the latest in a long line of GOZ attempts to avoid fundamental economic reform and maintain the government,s vise-grip on the economy. Like all those that have gone before, they will also fail to stem the country,s accelerating economic decline.
SCHULTZ